



CHARTERED CERTIFIED ACCOUNTANTS

Article topic: Financial Reporting

May 2010

Accounting for Goodwill and Intangible Assets

This article looks at the fundamental principles in accounting for goodwill and intangible assets and also looks at some fundamental differences between current UK GAAP, IFRS and the proposed IFRS for SMEs.

As accountants we are all aware that an intangible asset does not have any physical form and accounting for such assets has always been a major issue for the accounting profession for many years. Goodwill particularly has always posed problems.

Goodwill

Goodwill can primarily take two forms: purchased goodwill and internally-generated goodwill. Goodwill is accounted for under the provisions in FRS 10 'Goodwill and Intangible Assets' and IFRS 3 'Business Combinations'.

Under IFRS 3, internally-generated goodwill cannot be capitalised. This also applies to internally-generated brands such as mastheads, publishing titles, customer lists etc in substance. They should, instead, be treated as either research or development costs in accordance with the principles in IAS 38 'Intangible Assets'.

FRS 10 allows internally-generated intangible assets to be capitalised only if there is a readily ascertainable market value and specifically prohibits the capitalisation of internally-generated goodwill. Where readily ascertainable values are not available then costs incurred should be written off to the profit and loss account as incurred.

Measurement

FRS 10 requires purchased intangible assets to be capitalised at cost and amortised over its estimated useful life. FRS 10 defines the useful economic life of an intangible asset as:

'the period over which the entity expects to derive economic benefits from that asset'.

In some respects, goodwill and other capitalised intangible assets may be deemed to have an indefinite useful economic life or a useful economic life of more than 20 years. A useful economic life of more than 20 years can only be chosen if two criteria are met:

- The lifespan of the intangible asset(s) can be demonstrated to be longer than 20 years; and
- The intangible asset is capable of continued measurement in order that annual impairment reviews can be undertaken.

For all intangible assets that have been deemed to have either an indefinite life or a lifespan of more than 20 years, annual impairment reviews must be undertaken in accordance with IAS 36 'Impairment of Assets' or FRS 11 'Impairment of Fixed Assets and Goodwill'. If the impairment test reveals an impairment, then the asset should be written down to its recoverable amount.

Recoverable Amount

Assets carried in the balance sheet (statement of financial position) should never be carried at anymore than their recoverable amount. IAS 36 'Impairment of Assets' and FRS 11 'Impairment of Fixed Assets and Goodwill' are similar in their determination of recoverable amount.

Under both standards, recoverable amount is the HIGHER of:

- Fair value less costs to sell; and
- Value in use.

Fair value less costs to sell is the amount obtainable from the sale of an asset or cash-generating unit in an arm's length transaction between knowledgeable, willing parties, less the costs involved in the disposal.

Value in use is the present value of the future cash flows expected to be derived from an asset or cash-generating unit.

A *cash-generating unit* is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

Revaluation of Intangible Assets

FRS 10 prohibits the revaluation of intangible assets after their initial recognition at cost or fair value on acquisition. Only in rare situations can intangible assets be revalued and such situations are where there are readily ascertainable market values. Where such readily ascertainable market values are available, then all intangible assets within the same class of intangible assets must be revalued.

Disclosures

The following are required to be disclosed in an entity's financial statements in relation to intangible assets:

- Valuation method.
- For each class of intangible asset:
 - The cost or revalued amount at the start of the accounting period.
 - The cumulative provisions for amortisation or impairment at the beginning and end of the period.
 - A reconciliation of the movements, showing additions, disposals, revaluations, transfers, amortisation, impairment losses and reversals of past impairment losses.
 - Carrying amount at the reporting date.
- The method of amortisation together with the reasons for choosing the method of amortisation.
- The reasons for, and the effect of, changing useful economic lives.
- The reasons for, and the effect of, changing amortisation methods.
- Where an intangible asset is amortised over more than 20 years, or has an indefinite life and is therefore not amortised, the reasons for rebutting the 20 year presumption.

Where intangible assets have been revalued:

- The year in which the revaluation took place and the basis of valuation.
- The original cost or fair value and the amount of any amortisation provisions that would have been recognised if the intangible asset had not been subject to revaluation.
- The name and qualifications of the person who valued the intangible asset.

UK GAAP versus IFRS

Under the provisions in IFRS 3 'Business Combinations' goodwill amortisation is prohibited, whereas FRS 10 permits goodwill amortisation if the useful economic life of the purchased goodwill is less than 20 years. IFRS 3 requires annual impairment tests, whereas FRS 10 requires annual impairment tests on goodwill if the useful economic life of the goodwill is more than 20 years.

The proposed IFRS for SMEs allows amortisation of goodwill if the expected useful life of goodwill is less than 10 years. If it is more than 10 years, then annual impairment tests are required. In contrast, FRS 10 refers to an expected useful economic life of more than 20 years.

Steve Collings FMAAT FCCA DipIFRS is the audit and technical director at Leavitt Walmsley Associates Ltd and a partner in AccountancyStudents.co.uk. He is also the author of 'The Core Aspects of IFRS and IAS' and lectures on financial reporting and auditing issues.